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BEFORE THE ARIZONA CORPORATION COMMISSION

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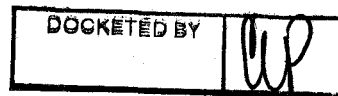
Arizona Corporation Commission  
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AZ CORP COMMISSION  
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JIM IRVIN  
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NOV 26 2001

MARC SPITZER  
Commissioner



IN THE MATTER OF ARIZONA PUBLIC  
SERVICE COMPANY'S REQUEST FOR A  
VARIANCE OF CERTAIN REQUIREMENTS  
OF A.A.C. R14-2-1606

DOCKET NO. E-01345A-01-0822

**REPLY OF ARIZONA PUBLIC SERVICE COMPANY  
TO RESPONSE OF COMMISSION STAFF**

Arizona Public Service Company ("APS" or "Company") is appreciative of receiving the Utilities Division Staff ("Staff") Response in the above captioned proceeding, and the Company agrees with the need to collaboratively establish a prompt schedule for the Commission's consideration of the APS request. But APS is seriously concerned that the Response represents an unwarranted and potentially dangerous pre-judgment of the Company's application prior to receiving responses to a single Staff data request, prior to any meetings with APS to discuss the filing and prior to any in-depth internal Staff analysis. Just as troublesome are the Staff's statements concerning the intent and scope of the October 18th filing by the Company and Staff's proposed solution – an exhaustive re-examination of retail electric competition in Arizona, including both the APS and Tucson Electric Power Company ("TEP") 1999 rate settlements. And although APS does interpret the Response as essentially a motion for a procedural order and scheduling conference, requests with which it agrees, APS finds itself compelled to address both Staff's statements concerning the Company's filing and the overly broad solution suggested by Staff.

## I. INTRODUCTION

APS' filing responsibly addressed several critical issues facing the Company, its customers and the Commission, namely:

1. the obligation of incumbent utility distribution companies ("UDC's") such as APS to provide reliable electric service to Standard Offer customers after 2002;
2. the significant short-term and long-term investments and other efforts made by APS and its affiliates to meet this obligation;
3. the need for retail rate stability amidst a volatile and unpredictable wholesale electric market;
4. the ability of the current wholesale generation market to support a viable competitive bidding process of the magnitude envisioned by Rule 1606 (B); and,
5. the potential for a California-type debacle of large rate increases, financial peril for incumbent UDC's, supply constraints and resultant customer dissatisfaction.

APS is extremely disappointed that Staff's Response either ignores or hastily dismisses these significant concerns.

APS sought only a variance to one subsection of one of the Arizona Corporation Commission's 17 electric competition rules. It did not seek exemption from the rule, as has been granted the co-operatives by the Commission and public power entities by the Legislature. It did not seek a complete waiver of the rule as has been previously granted to Citizens Communications Company. The Company's request is specifically authorized by A.A.C. R14-2-1614 (C). Moreover, even under its proposal, APS would be competitively bidding for more generation by 2008 than any other Arizona UDC.

The proposed purchased power agreement ("PPA") represents the commitment to APS of Pinnacle West Energy Corporation ("PWEC") resources at essentially cost-of-service. PWEC was under no legal obligation to make such a commitment under

1 either terms of the 1999 rate settlement or the Commission's Electric Competition  
2 Rules. In addition to cost-based rates, the PPA between APS and Pinnacle West  
3 Capital Corporation ("PWCC") provides stability and reliability not obtainable from  
4 the competitive wholesale market, and provides ample opportunities for non-affiliated  
5 generators to participate in both serving APS customers and the broader Southwest  
6 power market. Although APS certainly expects the Commission to carefully scrutinize  
7 the PPA, it believes that dismissing the PPA out-of-hand, underestimating the  
8 importance of reliability or assuming as of yet unproven impacts on the wholesale  
9 competitive market are clearly premature conclusions that will inevitably lead to the  
10 adoption of unwise policies.

11  
12 **II.**  
13 **APS SUPPORTS ISSUING A PROCEDURAL ORDER**  
14 **AND/OR HOLDING A PROCEDURAL CONFERENCE FOR**  
15 **THE TIMELY CONSIDERATION OF THE COMPANY'S REQUEST**

16 APS agrees that an evidentiary hearing or other proceeding on the Company's  
17 request (and only the Company's request) be scheduled as quickly as possible through  
18 the issuance by the Hearing Division of a Procedural Order that will allow a prompt  
19 Commission decision. If this necessitates the pre-filing of written testimony, then a  
20 schedule for the filing of all such testimony (including Staff's and intervenors), as well  
21 as associated dates for intervention and hearing should be set consistent with Staff's  
22 suggestion that APS provide direct testimony by December 7, 2001. Alternatively, the  
23 Hearing Division could order an immediate scheduling conference to attempt to work  
24 out an agreed-upon set of procedural dates prior to issuance of its final procedural  
25 schedule. There is simply no legitimate reason to require only the Company to file its  
26 testimony and then "meet and confer" on the balance of the procedural schedule as  
Staff has suggested in its Response.

**III.**  
**STAFF'S REQUEST FOR AN ORDER PROHIBITING THE TRANSFER  
OF APS GENERATION TO PWEC IS UNNECESSARY AND UNLAWFUL**

Staff's request for some sort of preliminary "injunction" against the transfer of APS generating assets as required by the Electric Competition Rules and as authorized by Decision No. 61973 (October 6, 1999) is a material violation of the 1999 APS settlement agreement. The Commission's own Electric Competition Rules, as modified by the Commission pursuant to A.A.C. R14-2-1614 (C) in Decision No 61973, order APS to transfer its generation by the end of 2002 subject only to one precondition set forth in A.A.C. R14-2-1609 (I). APS has already satisfied that precondition pursuant to FERC-approved ancillary services (including must-run) agreements with PWEC and PWCC. Decision No. 61973 independently authorized the transfer of such assets pursuant to A.R.S. § 40-285 subject only to the submission of 30-days notice in conformance with the requirements set forth at page 10 of such Decision.

Although APS believes (and the Arizona Court of Appeals has found) that the entry of Decision No. 61973 formed a binding settlement agreement between the Commission and the Company on the subject of divestiture, one does not have to accept that view to reject Staff's highly improper request. Under any interpretation of Decision No. 61973, it is a valid Commission order until such time as it is set aside by a court of competent jurisdiction. Even if subsequently determined by the Arizona Supreme Court as not being such a binding contract, Decision No. 61973 could only then be amended in accordance with the provisions of A.R.S. § 40-252, which require that APS be afforded notice and hearing prior to any adverse amendment to its terms. Failure to afford an affected party a hearing required by statute is *per se* unlawful. *Southern Pacific Transportation Company v. Arizona Corporation Commission*, 173 Ariz. 630, 845 P.2d 1125 (App. 1992). Staff's Response seeks summary action by the

1 Commission without any mention of either the Company's rights under the settlement  
2 agreement or pursuant to statute.

3 Staff's request for a summary order blocking divestiture is as unnecessary as it  
4 is improper. At page 2 of its Response, Staff states: "The analysis of the PPA may  
5 yield different results if it takes place in an environment where the generation assets are  
6 no longer under the Commission's jurisdiction." Although APS submits that the  
7 referenced "analysis" of the PPA should be unaffected by the legal ownership of  
8 generating assets devoted to that agreement, the statement ignores the fact that the PPA  
9 cannot take effect until after divestiture (PPA, Section 11.1) and that divestiture is  
10 clearly not anticipated until after the variance has been granted and the PPA has  
11 received Commission approval. *Id.* To that end, APS (at Staff's specific request) filed  
12 a letter in this Docket explicitly stating that the October 18th filing was not the 30-day  
13 notice required by Decision No. 61973. See attached copy of letter to Commission  
14 counsel dated November 8, 2001.

15 The November 8 letter was provided the Commission specifically to avoid the  
16 sort of precipitous Commission action now urged by Staff. Any Commission order  
17 forcibly blocking APS divestiture, no matter how temporary or how couched with  
18 language recognizing the primacy of Decision No. 61973, will assuredly result in a  
19 significant and adverse reaction in the financial community. It will signal a clear intent  
20 to unilaterally and unlawfully abrogate the 1999 settlement. As the Commission no  
21 doubt recalls, the last time the market became fearful of such a reopening of the  
22 Company's prior rate settlement with the Commission (an incorrect assessment, as it  
23 turned out), the resultant loss in market value to the Company's shareholders was  
24 significant and immediate - over 100 million dollars in less than a week.

IV.  
**THE COMPANY'S REQUEST DOES NOT SEEK A CHANGE  
IN THE 1999 APS RATE SETTLEMENT AGREEMENT**

A. Sections 4.1.3 and 7.8

It is Staff's Response, not the Company's October filing, that seeks to improperly change the 1999 settlement. Staff's Response contends that the Company somehow seeks to alter Section 4.1.3 of the 1999 APS rate settlement agreement, approved with modifications in Decision No. 61973, or that the October filing represents a difference in interpretation of that provision by the parties that requires the signatories of the settlement to "meet and confer" pursuant to Section 7.8 of the agreement. *See* Response at page 4, lines 21-22; page 6, lines 24 – 26; and page 7 lines 15 – 18. However, neither Section 4.1.3 (which was not in the original settlement and was requested by a non-party to the settlement, Enron Energy Services during the Commission's deliberations on the agreement) nor Section 7.8 explicitly incorporate the competitive bidding requirement of Rule 1606 (B).<sup>1</sup> The former merely commits APS to follow the Electric Competition Rules as regards Standard Offer procurement, which rules expressly permit requests for variances. Indeed, the Commission has already granted several variances to Electric Competition Rules, at least one of which was also a subject area of the 1999 APS settlement – and without there even being a request on file. *See*, e.g., Decision No. 63354 (February 8, 2001) – APS and other Affected Utilities relieved of the obligation to divest a portion of their generation.

<sup>1</sup> The latter provision (Section 7.8) of the APS settlement is only triggered when APS becomes aware of a disagreement with another party to the settlement (which would not include Staff) over its interpretation. APS was not and is not aware of any such disagreement and has received no request from a party to the settlement for a conference, but will fully comply with its obligation to meet and confer whenever requested to do so.

1           B.     WestConnect

2           Although entirely unrelated to the October 18th request for variance, Staff also  
3 raises the issue of WestConnect as being somehow contrary to the 1999 APS settlement  
4 and the Electric Competition Rules.<sup>2</sup> See Response at page 4, lines 25 –28; page 6, line  
5 28 – page 7, line 2. This concern is as inexplicable as it is unmerited. With the  
6 Commission’s full knowledge, the Company has expended substantial resources in  
7 both time and money in its leadership role in forming first Desert Star and then its  
8 successor organization, WestConnect.

9           Rule 1609 (C) of the Electric Competition Rules clearly does not require that the  
10 RTO must be the then contemplated “Desert Star.” In fact, it does not even mention  
11 “Desert Star” as such. As to the reference to Desert Star in Section 7.6 of the APS  
12 settlement, it is merely intended as a generic reference to an RTO or ISO, since FERC  
13 would have the final say as to the structure of any such organization irrespective of the  
14 agreement or the wishes of the parties to that agreement, including the Commission. If  
15 any parties to the agreement now contend that Section 7.6 is tied to a specific name or a  
16 specific organization rather than to a concept (a “FERC-approved RTO or ISO” in the  
17 parlance of Rule 1609), APS will again offer to meet and confer with such parties.

18           Aside from its lack of relevance to the October filing or its relationship (or lack  
19 thereof) to the 1999 APS settlement and the Electric Competition Rules, APS was  
20 astounded by Staff’s apparent opposition to WestConnect. Although long aware of this  
21 alternative and public proposal to the moribund Desert Star (first proposed not by APS,  
22 but by El Paso Electric Company), Staff has never indicated so much as a word of  
23 opposition to the WestConnect concept, which draws heavily on the protocols  
24

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25           <sup>2</sup> APS does not know why Staff apparently believes this. Is it because WestConnect does not use the  
26 name “Desert Star” or because Staff does not consider West Connect to be a “Regional Transmission  
Organization” within the meaning of Rule 1609? The Response is silent.

1 developed for Desert Star. Even during face-to-face meetings with Staff during this  
2 past summer, APS received no negative comments on or objections to WestConnect.

3  
4 **V.**

5 **STAFF'S RESPONSE UNFAIRLY CRITICIZES APS' FILING FOR**  
6 **NOT PRESENTING DETAILED EVIDENTIARY SUPPORT**  
7 **RESPECTING THE REQUESTED VARIANCE**

8 Staff's Response devotes an entire section to the proposition that "APS HAS  
9 NOT PROVIDED ANY SUPPORT FOR ITS REQUEST." See Response at pages 5  
10 and 6. The Company filed precisely what is required by A.A.C. R14-2-1614 (C).  
11 Although many of the assertions by APS in the October filing are, in its opinion, self-  
12 evident (e.g., the volatility of the wholesale market, the failure of the Electric  
13 Competition Rules to address supply reliability, and the significant rate increases and  
14 reliability problems experienced in California and else where during the past 18  
15 months), the Company will address relevant evidentiary issues raised by Staff in  
16 whatever forum (evidentiary hearings, Open Meeting, etc.) the Commission finds  
17 appropriate for the consideration of the APS request.

18 Curiously, Staff provides no support of its own for the statements in the  
19 Response that the "APS Request has far reaching implications in connection with the  
20 Commission's attempts to restructure the electric utility industry in Arizona" (*Id.* at  
21 page 1); that "circumstances have clearly changed since the Commission adopted the  
22 Electric Competition Rules" (*Id.* at page 2); that "competitive bidding is an integral part  
23 of the development of the restructured electric generation market" (*Id.* at page 3); that  
24 "the term of the PPA would ensure that no competitive electric generation market could  
25 develop in Arizona for the next 15 years" (*Id.* at page 4 – emphasis supplied); that the  
26



1 PPA "would probably act to stifle any possibility of a competitive generation market  
2 developing anywhere in the state" (*Id.* at page 5 – emphasis supplied); or that "[T]he  
3 APS Request is in contravention of every objective of the Commission's Electric  
4 Competition Rules, as well as the APS Settlement" (*Id.* at page 3 – emphasis supplied).  
5 Other than agreeing with Staff's apparent belief that the generation market in the West  
6 is not mature enough to support a Rule 1606-size bidding requirement in 2003 (which  
7 was a primary reason for the Company's October 18th filing), APS does not believe  
8 Staff's sweeping assertions are correct or even address the relevant public interest  
9 issues relating to customer service and the development of a competitive market. APS  
10 therefore welcomes the opportunity to test these and other allegations made in the  
11 Response in the appropriate forum of the Commission's choosing.  
12

#### 13 VI.

#### 14 **ANY PROCEEDING ON THE OCTOBER FILING SHOULD NOT** 15 **ENCOMPASS A COMPLETE RE-EXAMINATION OF THE** 16 **ELECTRIC COMPETITION RULES AND THE APS OR TEP SETTLEMENTS**

17 APS' request for a variance to Rule 1606 (B) and approval of the proposed PPA  
18 deserve to be considered on their own merits and in a timely fashion. APS and its  
19 affiliates are investing well over a billion dollars to meet the present and future needs  
20 of APS customers and have taken a variety of responsible short-term measures to  
21 provide reliable electric service during the summer season. The Commission-ordered  
22 transfer of the great bulk of the Company's generation assets and the related and  
23 necessary "buy-back" of power memorialized in the PPA is an integral part of these  
24 plans and must be acted upon as soon as possible (preferably by year's end) and  
25 certainly well before the December 31, 2002 deadline. If the Commission will not  
26

1 recognize the Company's commitment to reliably serve its customers, then the  
2 Company needs to make immediate alternative arrangements to sell power elsewhere,  
3 review the status of existing projects, redeploy capital and revise long-term plans.  
4

5 This timetable cannot be reconciled with Staff's proposal to do a comprehensive  
6 "Mulligan" on the entire scope of the Electric Competition Rules or by attempting to  
7 unilaterally abrogate or renegotiate the APS, let alone the TEP, settlement in the  
8 context of this proceeding. The first go round on the Electric Competition Rules alone  
9 lasted from 1994 through the end of 1996.

10 If Staff seeks to amend the Electric Competition Rules, there both is a procedure  
11 and form of proceeding for such amendment set forth in the Arizona Administrative  
12 Procedure Act. Attempting to introduce collateral issues into the APS October filing is  
13 not the appropriate procedure, and this Docket is not the appropriate proceeding.

14 As noted in the INTRODUCTION, APS seeks only a variance to one of nine  
15 subsections from one of 17 of the Commission's Electric Competition Rules. It is less  
16 a variance of Rule 1606 (B) than has already been granted by the Commission to all the  
17 other Affected Utilities excepting TEP, and one that will still leave APS as the  
18 undisputed Arizona leader in the acquisition of competitively-bid generation for  
19 Standard Offer service. This is hardly be the cause of the sweeping proceeding  
20 envisioned by Staff, and using the October filing as pretext to such a omnibus  
21 proceeding does a disservice to the very "adequate, thoughtful and fair consideration of  
22 the request" suggested by Staff on the first page of its Response.  
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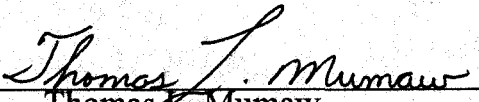
VII.  
CONCLUSION

APS asks only that Staff and the Commission give its request fair consideration. The Company believes nothing less than the continued reliability and price stability of Standard Offer service is at stake, and Staff certainly has not proposed any alternative to the proposed PPA other than continued reliance on Rule 1606 (B). Without the availability of a viable, reliable and reasonably-priced Standard Offer service to keep the competitive ESP's on their toes, most of APS' customers will find the promise of competition unfilled at best, or replaced by the nightmare of California at worst.

APS asks the Commission to reject Staff's improper and unnecessary request for an order prohibiting, even on an interim basis, the transfer of generation required by the Electric Competition Rules and authorized by Decision No. 61973. APS further asks that proceedings on the Company's request be scheduled as quickly as possible by prompt issuance of a comprehensive procedural order as discussed above, or alternatively, the Hearing Division could order an immediate scheduling conference to attempt to work out an agreed-upon set of procedural dates.

RESPECTFULLY SUBMITTED this 26th day of November, 2001.

SNELL & WILMER L.L.P.

  
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## **HAND-DELIVERED**

Janice M. Alward, Esq.  
Arizona Corporation Commission  
Legal Division  
1200 West Washington Street  
Phoenix, AZ 85007

**Re: Docket No. E-01345A-01-0822**

Dear Ms. Alward:

In response to your inquiry of November 7, 2001 concerning the Application of October 18, 2001, let me make the following statements on behalf of Arizona Public Service Company ("APS") or "Company"):

1. APS fully intends to transfer to an affiliate or affiliates all of its non-renewable generating assets as authorized by Decision No. 61973 and as required by A.A.C. R14-2-1615, prior to December 31, 2002.
2. Decision No. 61973 requires APS to provide the Arizona Corporation Commission ("Commission") with 30-days prior notice of the transfer of any of the Company's generating assets in the form specified at page 10 of that Decision.
3. The Company's October 18, 2001 filing in the above Docket was not nor was it intended to be the 30-day notice described in Decision No. 61973.

I hope this has removed any doubt in the Commission's mind as to both the Company's intentions and the legal import of the October 18th filing.

Janice M. Alward, Esq.  
November 8, 2001  
Page 2

Very truly yours,

SNELL & WILMER L.L.P.

A handwritten signature in cursive script, reading "Thomas L. Mumaw".

Thomas L. Mumaw  
Attorneys for Arizona Public Service Company

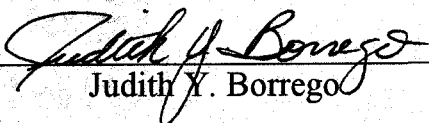
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**CERTIFICATE OF SERVICE**

The original and ten (10) copies of the foregoing document were filed with the Arizona Corporation Commission this 26th day of November, 2001, and service was completed by mailing, e-mailing, or hand-delivering a copy of the foregoing document this 26th day of November, 2001, to all parties of record herein.

  
Judith Y. Borrego